Hershey Foods Corporation Annual Report 1994

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Key Events

- Market share in the United States continued to improve and the confectionery market regained momentum as the year progressed.
- Hershey Chocolate U.S.A.'s sales gain was largely attributable to new products and line extensions.
- *Reese's NutRageous* bar was introduced in January and greatly exceeded expectations, becoming a major brand in its first year of distribution. *Twizzlers Pull-n-Peel* licorice candy was introduced in May and provided a significant boost to non-chocolate confectionery sales. *Hershey's Nuggets* chocolates were introduced in August and also provided significant sales in the second half of the year.

- New product introductions in the Canadian market during the year included *Hershey's Hugs* chocolates, *Peter Paul Mounds* and *Almond Joy* candy bars, and *Twizzlers Pull-n-Peel* licorice candy.
- Improved results were posted by the snack nut, licorice and boxed chocolates businesses in Canada. However, competitive pressures and reduced consumer demand hampered overall business performance. Furthermore, Canadian results, when measured in U.S. dollars, were negatively affected by the declining value of Canada's currency.

- Political and economic turmoil restricted the development of the Mexican confectionery market during 1994.
- The weakness of Mexico's currency, culminating in the December devaluation, had an adverse impact on results when reported in U.S. dollars.

- *Reese's Peanut Butter Puffs* cereal was introduced successfully in the first quarter through a licensing agreement with General Mills Inc., which manufactures, markets and distributes the product.
- New products in 1994 included: *Hershey's Hot Cocoa Collection* hot cocoa mix, *Hershey's* chocolate malt syrup, *Hershey's Chocolate Shoppe* candy bar sprinkles, *Peter Paul Mounds* sweetened coconut flakes, *Hershey's* bittersweet baking chocolate and *Reese's* bits for baking. Also introduced were aseptically packaged *Hershey's* chocolate shake, *Hershey's* chocolate lowfat milk and *Hershey's* lowfat milk.

- Export sales had another year of excellent growth, with particular strength in the Far East. In addition, select *Hershey's* products were introduced in the Russian market in late 1994.
- New licensing agreements were signed with Selecta Dairy Products, Inc. of the Philippines to manufacture *Hershey's* ice cream products and with Kuang Chuan Dairy Co., Ltd. in Taiwan to manufacture *Hershey's* beverages.

- The Division's highly efficient, state-of-the-art pasta manufacturing facility in Winchester, Va., exceeded expectations in lowering production costs.
- Low price levels of imported pasta, combined with substantially higher durum wheat costs, reduced the Division's profitability for the year.
- Imported pasta continued to gain share in the U.S. market in 1994, negatively affecting the overall domestic pasta industry.

	Major Products	Market Position
Hershey Chocolate North America	Hershey Chocolate North America was formed on January 1, 1995, when the operations of Hershey Canada and Hershey Mexico were combined with Hershey Chocolate U.S.A. In the United States, the Division produces such American favorites as *Hershey's* milk chocolate bars; *Hershey's Kisses, Hershey's Kisses With Almonds* and *Hershey's Hugs* chocolates; *Reese's* peanut butter cups; *Kit Kat* wafer bars; *Peter Paul Mounds* and *Almond Joy* candy bars; *York* peppermint patties and *Twizzlers* licorice candy.	Hershey Chocolate U.S.A. continued to enhance its position as the leading U.S. confectionery company during 1994. While it competes primarily in the chocolate category of the U.S. market, it has increased its emphasis on branded, non-chocolate confectionery items with its *Twizzlers* licorice candy and *Amazin' Fruit* gummy bears.
	The Division manufactures and markets many of the same brands in the Canadian market as it does in the United States, using a slightly different formula for *Hershey's* milk chocolate to better satisfy Canadian tastes. Brands unique to the Corporation's Canadian operations include *Brown Cow* and *Strawberry Cow* milk modifiers, *Chipits* baking chips, *Oh Henry!* candy bars, *Glosette* candy, *Pot of Gold* boxed chocolates, *Life Savers* candy, *Breath Savers* mints and *Planters* nuts.	Hershey Canada holds market leadership positions in the Canadian licorice candy, hard roll candy, sundae toppings, baking chips and shelled nuts categories. During the year, it made modest market share gains in the all-important chocolate bar category. *Pot of Gold* boxed chocolates continued to strengthen its leading position in the boxed chocolate category.
	The Division manufactures and markets chocolate products under the *Hershey's* brand name in the Mexican market. In addition, Hershey's products manufactured in the United States are imported and sold in Mexico.	The Division holds a major position in the chocolate confectionery category in Mexico. *Hershey's* chocolate drink is the number one brand in its category.
Hershey Grocery	Products include *Hershey's* cocoa, *Hershey's* syrup, *Reese's* peanut butter, *Hershey's* baking chocolate, *Hershey's* and *Reese's* baking chips, *Hershey's* chocolate drink and *Hershey's Chocolate Shoppe* toppings.	The Division was organized in 1994 to increase emphasis on marketing Hershey's full line of chocolate and chocolate-related baking products, ice cream toppings and milk modifiers, as well as peanut butter and other grocery items. *Hershey's* syrup and *Hershey's* cocoa continue to enjoy leadership positions in their respective categories.
Hershey International	The Division exports *Hershey's* branded confectionery and grocery products to over 60 countries worldwide. It also manufactures and/or markets chocolate and confectionery products in Germany under the *Gubor* brand; in Italy under *Sperlari, Dondi, Scaramellini* and other brands; in Belgium and the Netherlands under the *Jamin* brand and private labels; and in Japan under the *Hershey's* brand. Hershey's branded products also are manufactured and sold in various other markets through licensing arrangements.	Hershey International is a leading non-chocolate confectioner in Italy and operates chocolate and confectionery businesses in Germany, Belgium, the Netherlands and Japan. The Division also conducts rapidly growing export and licensing businesses utilizing *Hershey's* brands and products specifically developed for international markets, such as *Hershey's* extra creamy milk chocolate.
Hershey Pasta Group	The Division produces a broad array of dry pasta products under such regional brands as *American Beauty, Ideal by San Giorgio, Light 'n Fluffy, Mrs. Weiss, P&R, Ronzoni, San Giorgio* and *Skinner.*	Hershey Pasta Group is the market leader in the U.S. retail dry pasta category. The Division's regional approach to marketing has been instrumental in establishing and enhancing this leadership position.


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Hershey Foods Corporation is the leading North American manufacturer of high-quality chocolate and other confectionery products, is the leading domestic producer of branded, dry pasta products and has a variety of international operations.

Our mission is to be a focused food company in North America and selected international markets and a leader in every aspect of our business.

In North America, our goal is to enhance our number one position in confectionery and achieve number one positions in pasta and chocolate-related grocery products.

Change...

to ensure continued growth

To our stockholders:

Last year, our centennial, was a time

Management Committee, left to right:
Michael F. Pasquale President, Hershey Chocolate North America
Jay F. Carr President, Hershey International
C. Mickey Skinner President, Hershey Pasta Group
Robert M. Reese Vice President and General Counsel
William F. Christ Senior Vice President and Chief Financial Officer
Kenneth L. Wolfe Chairman of the Board and Chief Executive Officer
Joseph P. Viviano President and Chief Operating Officer

of significant change at Hershey Foods Corporation.

...both at the Corporate and Division levels. Equally important, employees throughout the Corporation were challenged to emphasize even greater process efficiencies and continuous improvement in all aspects of their jobs.

Such change is difficult and at most companies is undertaken only in response to severe financial or operational problems. We are embarking on this process of change to lay the foundation for continued, profitable growth at a time when we are financially strong. In this context, we also have worked very hard to maintain the traditional company values that have made us successful over the past century.

Our new management team had a solid year of experience under challenging circumstances. We again achieved record sales and earnings from operations despite a soft domestic confectionery market in early 1994 and the extremely high cost of durum wheat for the U.S. pasta industry. Net sales increased by 3.4 percent to $3.6 billion, with virtually all of the gain resulting from volume growth. Net income per share for 1994, excluding the restructuring charge referenced below, was $3.04 per share, an increase of 6.3 percent over the $2.86 per share reported in 1993, after excluding one-time accounting changes and the gain on the sale of the Freia Marabou investment.

During 1994, we conducted a comprehensive review of domestic and international operations. We then developed a restructuring plan to enhance the performance of operating assets by lowering operating and administrative costs, eliminating underperforming assets and streamlining the overall decision-making process. An after-tax restructuring charge of $80.2 million, or $.92 per share, was recorded in the fourth quarter of 1994. The restructuring program is being implemented throughout 1995, and we expect these actions will enhance our earnings growth in 1996 and beyond.

After a slow start for chocolate and confectionery sales in the United States in 1994, Hershey Chocolate U.S.A. finished well and achieved excellent earnings growth as cost reductions, productivity improvements and somewhat lower selling and administrative expenses combined to produce improved operating margins. While the U.S. confectionery market achieved reasonable growth of four to five percent at retail during the year, retail sales of our products grew at a greater rate, resulting in improved market share.

Our sales to customers such as grocery stores, distributors, mass merchandisers and drugstore chains, however, grew at a slower rate. We believe this may have been

A new management team introduced wide-

Financial Highlights

In thousands of dollars except per share amounts	1994	1993	Percent Change
Net sales	**$3,606,271**	$3,488,249	+ 3
Income before accounting changes and one-time items	**264,424**[a]	256,649[b]	+ 3
Net income	**184,219**	193,325	– 5
Income per share:			
Before accounting changes and one-time items	**3.04**[a]	2.86[b]	+ 6
Net income	**2.12**	2.15	– 1

(a) See Notes to Consolidated Financial Statements for discussion of the restructuring charge recorded in 1994.
(b) See Notes to Consolidated Financial Statements for discussion of the net cumulative effect of accounting changes for income taxes and post-retirement benefits, and a one-time gain on the sale of the Corporation's investment in Freia Marabou a.s in 1993.

due in part to a reduction in our customers' inventory levels as they worked to improve their process efficiencies and cash flow. We have made every effort to accommodate their needs in these areas. In addition, we have made great strides in working with our customers to help them manage their confectionery sales efforts and maximize product turnover to our mutual benefit.

New products and line extensions were the primary source of sales growth at Hershey Chocolate U.S.A. in 1994. *Reese's NutRageous* bar and *Hershey's Nuggets* chocolates were particularly effective in boosting chocolate sales for the Division. Reduced cycle time in the conception, development, testing and introduction of new products

In view of the changing market environment, we adjusted our strategic plan in 1994 to reflect our intention to be a focused food company in North America and in selected international markets. Our strategy is to enhance our leadership position in chocolate and confectionery in North America, building upon the opportunities created by the North American Free Trade Agreement (NAFTA). For this reason, effective January 1, 1995, we realigned our North American chocolate and confectionery operations (United States, Canada and Mexico) into a new Division called Hershey Chocolate North America. We plan to build upon the strengths of our domestic operations to improve our competitive positions in the Canadian and Mexican markets

categories provides a distinct competitive advantage.

Hershey Grocery had a strong finish and contributed to the Corporation's earnings growth for the year. A new source of business for this Division is its increased involvement in licensing and other forms of cooperation with select, quality food companies. These arrangements allow us to enter categories where we can leverage our strong brand franchises by utilizing the production capabilities, distribution networks and marketing experience of our partners. When these companies promote and advertise new products bearing Hershey Foods' brand names, our overall brand franchise with the consumer is strengthened.

ranging organizational changes...

has become a hallmark of Hershey Chocolate U.S.A.

The successful introduction of *Twizzlers Pull-n-Peel* licorice candy, which capitalized on new technology to make a product unique to the licorice business, reflected our increased interest in the non-chocolate confectionery category. This category still is a relatively small part of our total confectionery business. However, our non-chocolate sales are growing at a faster rate than our chocolate sales and also are growing at a rate greater than our competitors' sales in this category.

and to enhance our overall returns.

In addition, we reorganized our domestic chocolate and confectionery business to focus our selling and marketing efforts on specific product categories. These new business units are: Hershey Chocolate U.S.A.—Chocolate Confectionery, Hershey Chocolate U.S.A.—Non-Chocolate Confectionery and Hershey Chocolate U.S.A.—Special Markets.

The new Hershey Grocery Division was formed at the beginning of 1994 to concentrate on marketing both chocolate-related and other, select grocery items. We believe the ability to dedicate sales and marketing resources to specific

An excellent example of this new emphasis is the introduction of *Reese's Peanut Butter Puffs* cereal in the first quarter of 1994, a cooperative effort with General Mills Inc. This arrangement represents Hershey's first major venture into the cereal category and combines the strength and equities of both companies.

Hershey Pasta Group enhanced its position as the U.S. market leader in retail dry pasta, posting record sales in 1994. Profitability declined, however, due to low price levels of imports and substantially

higher semolina costs resulting from a poor 1993 durum wheat harvest. Also affecting profitability were U.S. government actions which placed a substantial tariff on Canadian wheat imports, thereby inflating wheat costs for U.S. manufacturers.

This Division implemented price increases, achieved record productivity gains, and reduced selling and administrative expenses. It also benefited from the strong performance of its state-of-the-art manufacturing facility in Winchester, Va. These actions, however, were not sufficient to fully offset the substantial semolina cost increases.

The U.S. pasta market grew approximately three percent in 1994, and we expect continued growth in 1995. Hershey Pasta Group is well-positioned to participate in this growth with its strong regional brands and its focus on customer service, productivity and product quality.

The Corporation's international businesses struggled to contend with strong competitive pressures as well as soft confectionery markets and adverse economic conditions in certain countries during 1994. We have reassessed our strategic approach to international investments and have focused our attention on areas where we can gain important market positions in the future while generating acceptable rates of return. Hershey International formed interdisciplinary teams to investigate various markets and formulate appropriate entry strategies. Simultaneously, we began to evaluate our current international operations to ensure that these businesses continue to meet our long-term strategic objectives.

Our capital expenditures of approximately $140 million in 1994 were significantly lower than the $200 million average of the previous five years. Nevertheless, our capital expenditure program continued to support expanded production capacity and facilities modernization during the year. Both Hershey Chocolate U.S.A. and Hershey Pasta Group benefited from the full utilization of major new production facilities. We anticipate that capital expenditures for 1995 will approximate 1994's level.

Dividends paid to stockholders increased for the 20th consecutive year during 1994. The quarterly dividend on the Corporation's Common Stock increased 8.3 percent to $.325 per share in September 1994.

Our $200 million stock repurchase program, begun in mid-1993, continued throughout 1994 and was nearly 90 percent complete by year-end.

H. Robert Sharbaugh, a member of our Board of Directors since 1982, retired from the Board on January 4, 1995. Hershey Foods has benefited greatly from his vast experience and solid advice.

As we face 1995 and beyond, we feel that Hershey Foods is changing to meet both today's and tomorrow's challenges. Our long-term objective is to enhance shareholder value through improved earnings, returns and cash flow.

Finally, a recent nationwide survey indicated that Hershey Foods enjoys a substantial measure of consumer goodwill among the largest U.S. companies which provide consumer products or services. This goodwill is a direct result of our employees' dedication to providing the best quality products at the best possible value. On a daily basis we see evidence of employees at all levels throughout the Corporation working diligently to improve internal processes, decrease costs, increase customer service and improve product quality.

We would like to share with you some of these employee stories. On the following pages, you will meet Hershey Foods employees who exemplify the Hershey spirit in meeting the challenges of the market, driving the Corporation to higher levels of performance.

Kenneth L. Wolfe
Chairman of the Board and
Chief Executive Officer

Joseph P. Viviano
President and
Chief Operating Officer

Innovation

We've had to change our organizational structure to reduce the cycle time required to get new products to market. By utilizing electronic imaging systems and drawing upon the efficiencies of our supplier partnerships, we have dramatically cut the time required to design and produce new packaging.

These strong partnerships are based on understanding, commitment and trust between Hershey and its suppliers. We work together to drive all possible costs out of the system without sacrificing quality. In many cases, our suppliers understand our business so well they function as if they were our employees.

Jay Wilkinson Manager, Confectionery Packaging, Hershey Chocolate U.S.A.

Focus

With the company's increased focus on non-chocolate confectionery, those of us who make *Twizzlers* licorice products are very excited about our contribution to the Corporation's growth. When I started 17 years ago, we used a traditional process to make licorice. For the *Twizzlers Pull-n-Peel* product, we are using a new technology which saves a tremendous amount of time, labor and energy.

Watching the new process evolve has been great, and to be a part of it and finally see it happen has been fabulous. There's been a lot to learn, but it makes every day more challenging. It's great here. Everyone works together and your input is valued.

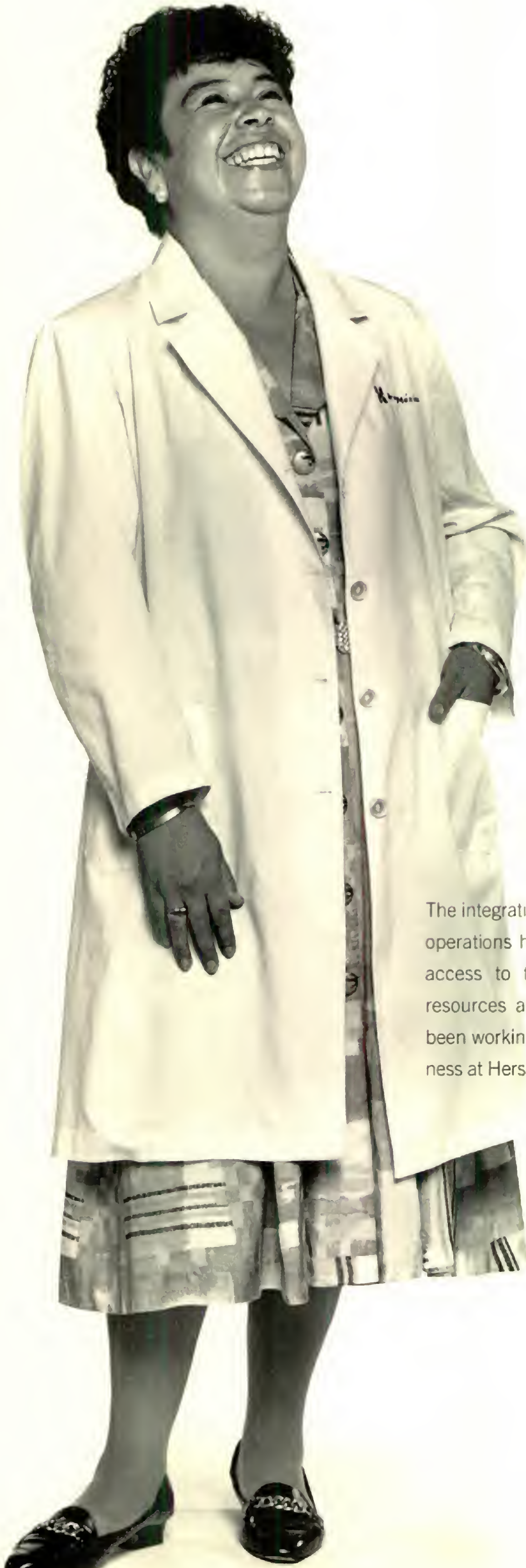
Steve Donnan Operative, Y&S Candies Plant, Lancaster, Pa., Hershey Chocolate U.S.A.

International growth

I'm honored to be serving on one of three Hershey International interdisciplinary teams looking at opportunities for international growth. These teams include individuals with broad expertise in sales, marketing, finance, manufacturing, logistics, human resources, and research and development who were given the opportunity to analyze select markets and propose appropriate entry strategies.

We have strong support from senior management, as well as assistance from many departments throughout the Corporation. It's been an excellent team approach, one which we believe will increase shareholder value over time.

John Dunn Brands Manager, Hershey Chocolate U.S.A.



Synergy

The integration of Hershey's U.S., Mexican and Canadian operations has given Hershey Mexico greatly improved access to the Corporation's technical and financial resources as well as management systems. We have been working hard to create an atmosphere of inclusiveness at Hershey Mexico.

All employees have participated in training sessions in key aspects of Hershey's way of doing business, and the growth in pride that comes from being part of a progressive company has been enormous. The commitment to do the best job possible for Hershey Mexico has created an entirely new mentality among employees. We do the best we can because we want to, not because we have to.

Margarita Araiza Supervisor of Laboratories and Inspection, Hershey Mexico, S.A. de C.V.

Efficiency

At Winchester, we know that our mission is to be the premier pasta plant in the world. To achieve the goal of lowest-cost pasta producer, we realize it takes more than state-of-the-art equipment. We involve all employees in understanding the entire production process through training and sharing information on a continual basis. This enables them to take responsibility and make decisions for themselves. Therefore, employees can anticipate or avoid problems and keep the plant running as efficiently as possible, constantly reducing the cost of production.

Tony Evans Coordinator, Winchester Plant, Winchester, Va., Hershey Pasta Group

Implementation

We're able to go to our customers with many innovative ideas about selling pasta. These ideas stem from a set of computerized programs we've named *Pasta Manager*. This sophisticated analytical tool enables us to be more responsive to changes in the marketplace and our customers' needs. We are able to convert raw data into valuable information for our customers, improving the way they market pasta to grow their businesses along with our own. This program strengthens relationships with our customers and positions Hershey Pasta Group as *The Pasta Experts*.

Rodney Plunkett Brands Manager, Hershey Pasta Group

Recently, we've become more involved in licensing and other forms of cooperation with select, quality food companies. These arrangements allow us to extend our brands into areas where we can utilize the production capabilities, distribution networks and marketing experience of other companies. Our brands bring value to these "partnerships" because of the quality of Hershey's products.

Also, our "partners" promote and advertise the fact that they use Hershey's products, thereby strengthening our overall brand franchise with the consumer. When we jointly bring a new product to market, combining Hershey's strengths with those of another fine food company, it's a win-win situation.

Dorothy Pharmer Brands Manager, Food Service/Licensing, Hershey Grocery

Partnership

Financial Review

- Record annual sales and income before accounting changes and one-time items — both up 3% versus 1993.
- Sales volume growth from introduction of new products, line extensions and 1993 acquisitions.
- Selling, marketing and administrative costs lower than 1993.
- Restructuring charge resulting from plan to enhance performance of operating assets.
- Record high Operating Return on Average Invested Capital.
- Twentieth consecutive annual Common Stock dividend increase.

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Management's Discussion and Analysis — Financial Review

Summary of Consolidated Operating Results

The Corporation achieved increased sales in 1994 and 1993. Net sales during this two-year period increased at a compound annual rate of 6%, primarily reflecting volume growth from new product introductions and international acquisitions, and pasta price increases. These increases were offset somewhat by lower sales for existing confectionery brands in most of the Corporation's domestic and international markets beginning late in the first quarter of 1993.

Hershey Pasta Group increased wholesale prices and curtailed certain promotion allowances in late 1993 and early 1994 because of increased semolina costs. The combined price increases averaged approximately 4%.

During the fourth quarter of 1994, the Corporation recorded a pre-tax restructuring charge of $106.1 million which reduced net income by $80.2 million. The restructuring charge was the result of a comprehensive review of domestic and international operations designed to enhance performance of operating assets by lowering operating and administrative costs, eliminating underperforming assets and streamlining the overall decision-making process.

Effective January 1, 1993, the Corporation adopted Statements of Financial Accounting Standards No. 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions" (FAS No. 106) and No. 109 "Accounting for Income Taxes" (FAS No. 109) by means of catch-up adjustments. The net charge associated with these changes in accounting had the effect of decreasing net income by approximately $103.9 million, or $1.16 per share.

In March 1993, the Corporation recorded a pre-tax gain of $80.6 million on the sale of its 18.6% investment interest in Freia Marabou a.s (Freia) which had the effect of increasing net income by $40.6 million.

Income, excluding the 1994 restructuring charge, increased at a compound annual rate of 4% during the two-year period. This increase was a result of the growth in sales, partially offset by a lower gross profit margin and higher selling, marketing and administrative expenses.

Summary of Financial Position and Liquidity

The Corporation's financial position remained strong during 1994. The capitalization ratio (total short-term and long-term debt as a percent of stockholders' equity, short-term and long-term debt) was 25% as of December 31, 1994, and 27% as of December 31, 1993. The ratio of current assets to current liabilities was 1.2:1 as of December 31, 1994, and 1.1:1 as of December 31, 1993.

Historically, the Corporation's major source of financing has been cash generated from operations. Generally, seasonal working capital needs peak during the summer months and have been met by issuing commercial paper.

During the three-year period ended December 31, 1994, the Corporation's cash and cash equivalents decreased by $44.4 million. Total debt, including debt assumed, increased by $114.5 million during this same period reflecting the financing needs for several business acquisitions and a share repurchase program.

The Corporation anticipates that capital expenditures will be in the range of $125 million to $175 million per annum during the next several years as a result of continued modernization of existing facilities and capacity expansion to support new products and line extensions. As of December 31, 1994, the Corporation's principal capital commitments included manufacturing capacity expansion and modernization.

Gross proceeds from the sale of the Corporation's Freia investment interest in the amount of $259.7 million were received in April 1993 and a portion thereof was used for the early repayment of long-term debt.

In the second quarter of 1993, the Corporation's Board of Directors approved a share repurchase program to acquire from time to time through open market or privately negotiated transactions up to $200 million of its Common Stock. A total of 3,451,139 shares has been repurchased under the program, of which 3,187,139 shares were held as Treasury Stock as of December 31, 1994.

As of December 31, 1994, $100 million of debt securities remained available for issuance under a Form S-3 Registration Statement which was declared effective in June 1990. In November 1993, the Corporation filed another Form S-3 Registration Statement under which it may offer up to $400 million of additional debt securities. Proceeds from any offering of the $500 million of debt securities available under these shelf registrations may be used to reduce existing commercial paper borrowings, finance capital additions, and fund the share repurchase program and future business acquisitions.

Acquisitions and Divestiture

Operating results during the period were impacted by the following:

- October 1993 — The purchase of the outstanding shares of Overspecht B.V. (OZF Jamin). OZF Jamin manufactures chocolate and non-chocolate confectionery products, cookies, biscuits and ice cream for distribution primarily to customers in the Netherlands and Belgium.
- September 1993 — The acquisition of the Italian confectionery business of Heinz Italia S.p.A. (Sperlari). Sperlari is a leader in the Italian non-chocolate confectionery market and manufactures and distributes a wide range of confectionery products, including nougat and sugar candies. Products are marketed primarily under the *Sperlari*, *Dondi* and *Scaramellini* brands.
- March 1993 — The acquisition of certain assets of the Cleveland-area Ideal Macaroni and Weiss Noodle companies (Ideal/Mrs. Weiss).

- April 1992 — The sale of Hershey do Brasil Participacoes Ltda., a holding company which owned a 41.7% equity interest in Petybon S.A., to the Bunge & Born Group. Petybon S.A., located in Brazil, is a producer of pasta, biscuits and margarine products.

A further discussion of these acquisitions and divestiture can be found in Note 2 to the consolidated financial statements.

Other Items

The Corporation's net sales, net income and cash flows are affected by the timing of business acquisitions, new product introductions, promotional activities, price increases, and a seasonal sales bias toward the second half of the year. These factors, together with sluggish demand for existing brands, caused a decline in net sales and net income in the first quarter of 1994.

The Corporation's most significant raw materials include cocoa, sugar, milk, peanuts, flour and almonds. The Corporation attempts to minimize the effect of price fluctuations related to the purchase of these raw materials primarily through forward purchasing to cover future manufacturing requirements generally for periods from 3 to 24 months. With regard to cocoa and sugar, price risks are also managed by entering into futures and options contracts. At the present time, similar futures and options contracts are not available for use in pricing the Corporation's other major raw materials. Futures contracts are used in combination with forward purchasing of cocoa and sugar requirements principally to take advantage of market fluctuations which provide more favorable pricing opportunities and to increase diversity or flexibility in sourcing these raw materials. The Corporation's commodity procurement practices are intended to reduce the risk of future price increases, but also may potentially limit the ability to benefit from possible price decreases.

The cost of cocoa beans and the prices for the related commodity futures contracts historically have been subject to wide fluctuations attributable to a variety of factors, including the effect of weather on crop yield, other imbalances between supply and demand, currency exchange rates and speculative influences. Cocoa crops for the most recent four years fell somewhat short of demand resulting in supply deficits. Market prices in 1994 moved higher as a result of the supply deficits and this trend could continue in 1995 if stocks decline further. The Corporation's costs during 1995 will not necessarily reflect market price fluctuations because of its forward purchasing practices, premiums and discounts reflective of relative values, varying delivery times, and supply and demand for specific varieties and grades of cocoa beans.

The major raw material used in the manufacture of pasta products is semolina milled from durum wheat. The Corporation purchases semolina from commercial mills and is also engaged in a custom milling agreement to obtain sufficient quantities of semolina. In 1994, the Corporation's semolina costs per pound were the highest since 1981. The exceptionally high costs resulted from short supplies caused by a poor harvest in 1993, combined with U.S. Government tariffs on imports of Canadian wheat. The tariff agreement is scheduled to end in September 1995, but could be extended by the U.S. Government.

Generally, the Corporation has been able to offset the effects of increases in the cost of its major raw materials, particularly cocoa beans, through selling price increases or reductions in product weights. Conversely, declines in the cost of major raw materials have served as a source of funds to maintain selling price stability, enhance consumer value through increases in product weights, respond to competitive activity, develop new products and markets, and offset rising costs of other raw materials and expenses.

Capital Structure

The Corporation has two classes of stock outstanding, Common Stock and Class B Common Stock (Class B Stock). Holders of the Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

The Corporation's Common Stock is listed on the New York Stock Exchange (NYSE). On December 19, 1994, the Securities and Exchange Commission approved the previously proposed uniform voting rights policy which has been adopted by the NYSE, the American Stock Exchange and the National Association of Securities Dealers. The policy provides that the voting rights of existing holders of publicly traded common stock cannot be disparately reduced or restricted through any corporate action or issuance. Under the policy, the Corporation's and other listed companies' existing dual class structures have been grandfathered.

Market Prices and Dividends

Cash dividends paid on the Corporation's Common Stock and Class B Stock were $107.0 million in 1994 and $100.5 million in 1993. The annual dividend rate on the Common Stock is $1.30 per share, an increase of 8% over the 1993 rate of $1.20 per share. The 1994 dividend represented the 20th consecutive year of Common Stock dividend increases.

On February 7, 1995, the Corporation's Board of Directors declared a quarterly dividend of $.325 per share of Common Stock payable on March 15, 1995, to stockholders of record as of February 24, 1995. It is the Corporation's 261st consecutive Common Stock dividend. A quarterly dividend of $.295 per share of Class B Stock also was declared.

Hershey Foods Corporation's Common Stock is listed and traded principally on the NYSE under the ticker symbol "HSY." Approximately 31.3 million shares of the Corporation's Common Stock were traded during 1994.

The closing price of the Common Stock on December 31, 1994, was $48⅜. The Class B Stock is not publicly traded. There were 34,327 stockholders of record of the Common Stock and the Class B Stock as of December 31, 1994.

The following table shows the dividends paid per share of Common Stock and Class B Stock and the price range of the Common Stock for each quarter of the past two years:

	Dividends Paid Per Share		Common Stock Price Range*	
	Common Stock	Class B Stock	High	Low
1994				
1st Quarter	**$ .300**	**$ .2725**	**$53½**	**$45¾**
2nd Quarter	**.300**	**.2725**	**46¾**	**41⅝**
3rd Quarter	**.325**	**.2950**	**48**	**41⅛**
4th Quarter	**.325**	**.2950**	**49⅝**	**44½**
Total	**$1.250**	**$1.1350**		
1993				
1st Quarter	$ .270	$ .2450	$ 55⅞	$ 46½
2nd Quarter	.270	.2450	54⅝	45¾
3rd Quarter	.300	.2725	51⅞	43½
4th Quarter	.300	.2725	54¾	48⅝
Total	$ 1.140	$ 1.0350		

*NYSE — Composite Quotations for Common Stock by calendar quarter.

Operating Return on Average Stockholders' Equity

The Corporation's operating return on average stockholders' equity was 18.5% in 1994. Over the most recent five-year period, the return has ranged from 16.6% in 1990 to 18.5% in 1994. For the purpose of calculating operating return on average stockholders' equity, earnings is defined as net income, excluding the after-tax gain on business restructuring in 1990, the catch-up adjustment for accounting changes and the after-tax gain on the sale of the investment in Freia in 1993, and the after-tax restructuring charge in 1994.

Operating Return on Average Invested Capital

The Corporation's operating return on average invested capital was 15.6% in 1994. Over the most recent five-year period, the return has ranged from 13.4% in 1990 to 15.6% in 1994. Average invested capital consists of the annual average of beginning and ending balances of long-term debt, deferred income taxes and stockholders' equity. For the purpose of calculating operating return on average invested capital, earnings is defined as net income, excluding the after-tax gains on business restructuring and the sale of the investment in Freia, the catch-up adjustment for accounting changes, the after-tax restructuring charge in 1994, and the after-tax effect of interest on long-term debt.

Consolidated Statements of Income

In thousands of dollars except per share amounts

For the years ended December 31,	1994	1993	1992
Net Sales	**$3,606,271**	$3,488,249	$3,219,805
Costs and Expenses:			
Cost of sales	**2,097,556**	1,995,502	1,833,388
Selling, marketing and administrative	**1,034,115**	1,035,519	958,189
Total costs and expenses	**3,131,671**	3,031,021	2,791,577
Restructuring Charge	**(106,105)**	—	—
Gain on Sale of Investment Interest	**—**	80,642	—
Income before Interest, Income Taxes and Accounting Changes	**368,495**	537,870	428,228
Interest expense, net	**35,357**	26,995	27,240
Income before Income Taxes and Accounting Changes	**333,138**	510,875	400,988
Provision for income taxes	**148,919**	213,642	158,390
Income before Cumulative Effect of Accounting Changes	**184,219**	297,233	242,598
Net cumulative effect of accounting changes	**—**	(103,908)	—
Net Income	**$ 184,219**	$ 193,325	$ 242,598
Income Per Share:			
Before accounting changes	**$ 2.12**	$ 3.31	$ 2.69
Net cumulative effect of accounting changes	**—**	(1.16)	—
Net income	**$ 2.12**	$ 2.15	$ 2.69
Cash Dividends Paid Per Share:			
Common Stock	**$ 1.250**	$ 1.140	$ 1.030
Class B Common Stock	**1.135**	1.035	.935

The notes to consolidated financial statements are an integral part of these statements.

Net Sales

Net sales rose $118.0 million or 3% in 1994 and $268.4 million or 8% in 1993. The increase in 1994 was due to volume growth from new products and businesses acquired in late 1993, and pasta selling price increases. These increases were substantially offset by lower sales caused by reduced demand for existing confectionery and grocery brands which began late in the first quarter of 1993. Sales of the Corporation's Canadian and Mexican businesses were lower in 1994 due to volume declines resulting from adverse economic conditions and the impact of currency exchange rates. The increase in 1993 primarily reflected volume growth from new products and business acquisitions, and pasta selling price increases, which more than offset the effects of sluggish demand for existing brands in most of the Corporation's domestic and international markets.

Costs and Expenses

Cost of sales as a percent of net sales increased from 56.9% in 1992 to 57.2% in 1993 and 58.2% in 1994. The decrease in gross margin in 1994 was primarily the result of higher costs for certain major raw materials, particularly semolina, higher expenses for depreciation, and lower margins associated with the international businesses, partially offset by lower costs resulting from manufacturing efficiency improvements, and pasta selling price increases. The decrease in gross margin in 1993 reflected higher manufacturing costs related to new products, incremental manufacturing, shipping and depreciation costs associated with the completion and start-up of new manufacturing and distribution facilities, and recurring expenses associated with a change in accounting for post-retirement benefits. These higher costs and expenses were partially offset by lower costs for certain major raw materials and pasta price increases.

Selling, marketing and administrative costs decreased slightly in 1994 primarily due to reduced levels of promotion and advertising expenses for existing confectionery brands, largely offset by increased promotion and advertising expenses related to the introduction of new products and higher selling and administrative expenses associated with the 1993 business acquisitions. Selling, marketing and administrative costs increased in 1993 primarily as a result of higher promotion expenses associated with the sales volume growth and the introduction of new products, and incremental selling expenses related to business acquisitions.

Restructuring Charge

In the fourth quarter of 1994, the Corporation recorded a pre-tax restructuring charge of $106.1 million following a comprehensive review of domestic and international operations designed to enhance performance of operating assets by lowering operating and administrative costs, eliminating underperforming assets and streamlining the overall decision-making process. The charge of $106.1 million resulted in an after-tax charge of $80.2 million or $.92 per share in 1994.

The charge included $34.3 million of severance and termination benefits for the elimination of approximately 500 positions in the manufacturing, technical and administrative areas at both domestic and international operations. The charge also included anticipated losses on disposals of certain businesses of $39.1 million, product line discontinuations of $17.5 million and the consolidation of operations and disposal of machinery and equipment of $15.2 million. Approximately 60% of the charge was non-cash. Operating cash flows will be used to fund any severance or other cash items.

The restructuring program is expected to be completed in 1995 and result in annual savings of approximately $18.0 million starting in 1996.

Gain on Sale of Investment Interest

In March 1993, the Corporation sold its 18.6% investment interest in Freia and recorded a pre-tax gain of $80.6 million, or $40.6 million after tax.

Interest Expense, Net

Net interest expense increased $8.4 million in 1994 as higher short-term interest expense and reduced capitalized interest and interest income were only partially offset by lower fixed interest expense. Short-term interest expense was above prior year as a result of higher borrowing levels related to the share repurchase program and the 1993 acquisitions, and increased short-term borrowing rates. Fixed interest expense was less than prior year due to the retirement of long-term debt in 1993.

Net interest expense decreased $.2 million in 1993 as lower long-term interest expense, reflecting lower debt balances, and higher interest income more than offset a decrease in capitalized interest. Capitalized interest was below the prior year reflecting the completion of major long-term construction projects in late 1992 and early 1993 and a corresponding reduction in expenditures qualifying for interest capitalization in 1993.

Provision for Income Taxes

The Corporation's effective income tax rate was 44.7%, 41.8%, and 39.5% in 1994, 1993 and 1992, respectively. The increase in 1994 was principally due to the relatively low international income tax benefit associated with the manufacturing restructuring charge. The effective income tax rate was higher in 1993 than in 1992 largely as a result of the relatively high income taxes associated with the gain on the sale of the Freia investment and an increase in the Federal statutory income tax rate as provided for in the Revenue Reconciliation Act of 1993, which reduced net income by $5.5 million.

Net Cumulative Effect of Accounting Changes

Effective January 1, 1993, the Corporation adopted FAS No. 106 and FAS No. 109 by means of catch-up adjustments which decreased net income by approximately $103.9 million or $1.16 per share.

Net Income

Net income decreased by 5% in 1994. Excluding the after-tax effect of the 1994 restructuring charge, and the 1993 after-tax gain on the sale of the Freia investment and catch-up adjustments for accounting changes, income increased $7.8 million or 3% in 1994. Net income increased $14.1 million or 6% in 1993, excluding the catch-up adjustments for accounting changes and the Freia gain. Income as a percent of net sales, after excluding the after-tax 1994 restructuring charge and the 1993 net cumulative effect of accounting changes and the after-tax Freia gain was 7.3% in 1994, 7.4% in 1993 and 7.5% in 1992.

Hershey Foods Corporation

Consolidated Statements of Cash Flows

In thousands of dollars

For the years ended December 31,	**1994**	1993	1992
Cash Flows Provided from (Used by) Operating Activities			
Net income	**$ 184,219**	$ 193,325	$ 242,598
Adjustments to reconcile net income to net cash provided from operations:			
Net cumulative effect of accounting changes	**—**	103,908	—
Depreciation and amortization	**129,041**	113,064	97,087
Deferred income taxes	**(2,328)**	11,047	21,404
Restructuring charge	**106,105**	—	—
Gain on sale of investment interest	**—**	(80,642)	—
Changes in assets and liabilities, net of effects from business acquisitions:			
Accounts receivable — trade	**(36,696)**	(100,957)	(13,841)
Inventories	**7,740**	32,347	(20,262)
Accounts payable	**(10,230)**	(12,809)	(10,715)
Other assets and liabilities	**(60,577)**	110,259	(20,707)
Other, net	**20,032**	9,399	649
Net Cash Provided from Operating Activities	**337,306**	378,941	296,213
Cash Flows Provided from (Used by) Investing Activities			
Capital additions	**(138,711)**	(211,621)	(249,795)
Business acquisitions	**—**	(164,787)	—
Sale (purchase) of investment interest	**—**	259,718	(179,076)
Other, net	**(6,293)**	(1,947)	6,581
Net Cash (Used by) Investing Activities	**(145,004)**	(118,637)	(422,290)
Cash Flows Provided from (Used by) Financing Activities			
Net (decrease) increase in short-term debt	**(20,503)**	67,485	201,425
Long-term borrowings	**102**	1,130	1,259
Repayment of long-term debt	**(14,413)**	(104,792)	(32,173)
Cash dividends paid	**(106,961)**	(100,499)	(91,444)
Repurchase of Common Stock	**(39,748)**	(131,783)	—
Net Cash (Used by) Provided from Financing Activities	**(181,523)**	(268,459)	79,067
Increase (Decrease) in Cash and Cash Equivalents	**10,779**	(8,155)	(47,010)
Cash and Cash Equivalents as of January 1	**15,959**	24,114	71,124
Cash and Cash Equivalents as of December 31	**$ 26,738**	$ 15,959	$ 24,114
Interest Paid	**$ 36,803**	$ 32,073	$ 29,515
Income Taxes Paid	**177,876**	171,586	151,490

The notes to consolidated financial statements are an integral part of these statements.

Management's Discussion and Analysis — Cash Flows

Summary

Over the past three years, cash provided from operating activities and the net cash from the purchase and subsequent sale of the Corporation's investment interest in Freia exceeded cash requirements for capital additions and dividend payments by $194.1 million. Total debt, including debt assumed, increased during the period by $114.5 million, reflecting the financing needs for several business acquisitions and a share repurchase program. Cash and cash equivalents decreased by $44.4 million during the period.

The Corporation's income and, consequently, cash provided from operations during the year is affected by seasonal sales patterns, the timing of new product introductions, business acquisitions and price increases. Chocolate, confectionery and grocery seasonal and holiday-related sales have typically been highest during the third and fourth quarters of the year, representing the principal seasonal effect. Generally, the Corporation's seasonal working capital needs peak during the summer months and have been met by issuing commercial paper.

Operating Activities

During the past three years, depreciation and amortization have increased significantly as a result of continuing investment in capital additions and business acquisitions. Cash requirements for accounts receivable and inventories have tended to fluctuate during the three-year period based on sales during December and inventory management practices. The change in cash required for or provided from other assets and liabilities between the years was primarily related to commodities transactions and the timing of payments for accrued liabilities, including income taxes and in 1994, restructuring expenses.

Investing Activities

Investing activities included capital additions, several business acquisitions, and the purchase and subsequent sale of an 18.6% investment interest in Freia in 1992 and 1993, respectively. The income tax benefit associated with the 1994 restructuring charge and income taxes paid in 1993 on the Freia gain were included in operating activities. Capital additions during the past three years included the purchase of manufacturing equipment, construction of new manufacturing and office facilities, and expansion and modernization of existing facilities. Businesses acquired during the past three years included OZF Jamin, Sperlari and Ideal/Mrs. Weiss in 1993. Cash used for business acquisitions represented the purchase price paid and consisted of the current assets, property, plant and equipment, and intangibles acquired, net of liabilities assumed.

Financing Activities

Financing activities included debt borrowings and repayments, payment of dividends and the repurchase of Common Stock. During the past three years, short-term borrowings in the form of commercial paper or bank borrowings were used to fund seasonal working capital requirements, business acquisitions, the purchase of the Freia investment interest and a share repurchase program. A portion of the proceeds received from the sale of the Freia investment was used to repay long-term debt in 1993.

During 1993, the Corporation's Board of Directors approved a share repurchase program to acquire from time to time through open market or privately negotiated transactions up to $200 million of Common Stock. As of December 31, 1994, a total of 3,451,139 shares had been repurchased at an average price of $50 per share.

Consolidated Balance Sheets

In thousands of dollars

December 31,	1994	1993
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 26,738**	$ 15,959
Accounts receivable — trade	**331,670**	294,974
Inventories	**445,702**	453,442
Deferred income taxes	**105,948**	85,548
Prepaid expenses and other	**38,608**	39,073
Total current assets	**948,666**	888,996
Property, Plant and Equipment, Net	**1,468,397**	1,460,904
Intangibles Resulting from Business Acquisitions	**453,582**	473,408
Other Assets	**20,336**	31,783
Total assets	**$2,890,981**	$2,855,091
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	**$ 115,428**	$ 125,658
Accrued liabilities	**265,283**	301,989
Accrued restructuring reserves	**82,055**	—
Accrued income taxes	**8,718**	35,603
Short-term debt	**316,783**	337,286
Current portion of long-term debt	**7,954**	13,309
Total current liabilities	**796,221**	813,845
Long-term Debt	**157,227**	165,757
Other Long-term Liabilities	**303,056**	290,401
Deferred Income Taxes	**193,377**	172,744
Total liabilities	**1,449,881**	1,442,747
Stockholders' Equity:		
Preferred Stock, shares issued: none in 1994 and 1993	**—**	—
Common Stock, shares issued: 74,679,357 in 1994 and 74,669,057 in 1993	**74,679**	74,669
Class B Common Stock, shares issued: 15,242,979 in 1994 and 15,253,279 in 1993	**15,243**	15,253
Additional paid-in capital	**49,880**	51,196
Cumulative foreign currency translation adjustments	**(24,537)**	(13,905)
Unearned ESOP compensation	**(38,321)**	(41,515)
Retained earnings	**1,522,867**	1,445,609
Treasury — Common Stock shares, at cost: 3,187,139 in 1994 and 2,309,100 in 1993	**(158,711)**	(118,963)
Total stockholders' equity	**1,441,100**	1,412,344
Total liabilities and stockholders' equity	**$2,890,981**	$2,855,091

The notes to consolidated financial statements are an integral part of these balance sheets.

Management's Discussion and Analysis — Financial Condition

Assets

Total assets increased $35.9 million or 1% as of December 31, 1994, primarily as a result of capital additions and increases in current assets, offset somewhat by a decrease in intangibles from business acquisitions.

Current assets increased by $59.7 million reflecting higher accounts receivable and current deferred income taxes. The increase in accounts receivable was primarily related to higher sales occurring toward the end of the year. Current deferred income taxes increased as a result of the income tax benefit associated with the restructuring charge recorded in the fourth quarter.

The $7.5 million net increase in property, plant and equipment included capital additions of $138.7 million in 1994 and depreciation expense of $114.8 million.

The decrease in intangibles resulting from business acquisitions principally reflected amortization of intangibles, adjustments associated with the restructuring plan and final accounting for 1993 business acquisitions.

Liabilities

Total liabilities increased by $7.1 million as of December 31, 1994, primarily due to increases in deferred income taxes and long-term liabilities, substantially offset by decreases in current liabilities and long-term debt.

Current liabilities decreased by $17.6 million principally as a result of decreases in accrued liabilities related to benefits, marketing promotions and the timing of income tax payments. A decrease in short-term debt reflected lower commercial paper borrowing levels as a result of cash provided from operating activities and reduced spending for stock repurchases and capital additions. These decreases were largely offset by accrued restructuring reserves of $82.1 million associated with the Corporation's restructuring plan. Total accrued restructuring reserves of $106.1 million were recorded in the fourth quarter. As of December 31, 1994, $24.0 million of these reserves had been utilized.

The increase in other long-term liabilities primarily reflected increases in liabilities associated with employee post-retirement and pension benefits.

Deferred income taxes increased principally due to higher temporary differences resulting from the use of accelerated depreciation methods for tax purposes.

Stockholders' Equity

Total stockholders' equity increased by 2% in 1994 and has increased at a compound annual rate of 8% over the past 10 years.

Consolidated Statements of Stockholders' Equity

In thousands of dollars

	Preferred Stock	Common Stock
Balance as of January 1, 1992	$ —	$ 74,921
Net income		
Dividends:		
Common Stock, $1.030 per share		
Class B Common Stock, $.935 per share		
Foreign currency translation adjustments		
Conversion of Class B Common Stock into Common Stock		8
Incentive plan transactions		
Employee stock ownership trust transactions		
Balance as of December 31, 1992	—	74,929
Net income		
Dividends:		
Common Stock, $1.140 per share		
Class B Common Stock, $1.035 per share		
Foreign currency translation adjustments		
Conversion of Class B Common Stock into Common Stock		4
Incentive plan transactions		
Employee stock ownership trust transactions		
Repurchase of Common Stock		(264)
Balance as of December 31, 1993	—	74,669
Net income		
Dividends:		
Common Stock, $1.250 per share		
Class B Common Stock, $1.135 per share		
Foreign currency translation adjustments		
Conversion of Class B Common Stock into Common Stock		**10**
Incentive plan transactions		
Employee stock ownership trust transactions		
Repurchase of Common Stock		
Balance as of December 31, 1994	**$ —**	**$74,679**

The notes to consolidated financial statements are an integral part of these statements.

	Class B Common Stock	Additional Paid-in Capital	Cumulative Foreign Currency Translation Adjustments	Unearned ESOP Compensation	Retained Earnings	Treasury Common Stock	Total Stockholders' Equity
	$ 15,265	$ 52,509	$ 26,424	$ (47,902)	$ 1,214,034	$ —	$ 1,335,251
					242,598		242,598
					(77,174)		(77,174)
					(14,270)		(14,270)
			(23,940)				(23,940)
	(8)						—
		(741)					(741)
		361		3,194			3,555
	15,257	52,129	2,484	(44,708)	1,365,188	—	1,465,279
					193,325		193,325
					(84,711)		(84,711)
					(15,788)		(15,788)
			(16,389)				(16,389)
	(4)						—
		(1,269)					(1,269)
		487		3,193			3,680
		(151)			(12,405)	(118,963)	(131,783)
	15,253	51,196	(13,905)	(41,515)	1,445,609	(118,963)	1,412,344
					184,219		**184,219**
					(89,660)		**(89,660)**
					(17,301)		**(17,301)**
			(10,632)				**(10,632)**
	(10)						**—**
		(1,812)					**(1,812)**
		496		**3,194**			**3,690**
						(39,748)	**(39,748)**
	$15,243	**$49,880**	**$(24,537)**	**$(38,321)**	**$1,522,867**	**$(158,711)**	**$1,441,100**

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Significant accounting policies employed by the Corporation are discussed below and in other notes to the consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its subsidiaries after elimination of intercompany accounts and transactions. Investments in affiliated companies are accounted for using the equity method.

Cash Equivalents

All highly liquid debt instruments purchased with a maturity of three months or less are classified as cash equivalents.

Commodities Futures and Options Contracts

In connection with the purchasing of cocoa and sugar for anticipated manufacturing requirements, the Corporation enters into commodities futures and options contracts as deemed appropriate to reduce the effect of price fluctuations. In accordance with Statement of Financial Accounting Standards No. 80 "Accounting for Futures Contracts," these futures and options contracts are accounted for as hedges and, accordingly, gains and losses are deferred and recognized in cost of sales as part of the product cost.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation of buildings, machinery and equipment is computed using the straight-line method over the estimated useful lives.

Intangibles Resulting from Business Acquisitions

Intangible assets resulting from business acquisitions principally consist of the excess of the acquisition cost over the fair value of the net assets of businesses acquired (goodwill). Goodwill is amortized on a straight-line basis over 40 years. Other intangible assets are amortized on a straight-line basis over the estimated useful lives. The Corporation periodically evaluates whether events or circumstances have occurred indicating that the carrying amount of goodwill may not be recoverable. When factors indicate that goodwill should be evaluated for possible impairment, the Corporation uses an estimate of the acquired business' undiscounted future cash flows compared to the related carrying amount of net assets, including goodwill, to determine if an impairment loss should be recognized.

Accumulated amortization of intangible assets resulting from business acquisitions was $86.7 million and $73.4 million as of December 31, 1994 and 1993, respectively.

Foreign Currency Translation

Results of operations for international entities are translated using the average exchange rates during the period. For international entities, assets and liabilities are translated to U.S. dollars using the exchange rates in effect at the balance sheet date. Resulting translation adjustments are recorded in a separate component of stockholders' equity, "Cumulative Foreign Currency Translation Adjustments."

Foreign Exchange Contracts

The Corporation enters into foreign exchange forward and options contracts to hedge transactions primarily related to firm commitments to purchase equipment, certain raw materials and finished goods denominated in international currencies, and to hedge payment of intercompany transactions with its non-domestic subsidiaries. These contracts reduce currency risk from exchange rate movements. Gains and losses are deferred and accounted for as part of the underlying transactions. In entering into these contracts the Corporation has assumed the risk which might arise from the possible inability of counterparties to meet the terms of their contracts. The Corporation does not expect any losses as a result of counterparty defaults.

License Agreements

The Corporation has entered into license agreements under which it has access to certain trademarks and proprietary technology, and manufactures and/or markets and distributes certain products. The rights under these agreements are extendable on a long-term basis at the Corporation's option subject to certain conditions, including minimum sales levels. License fees and royalties, payable under the terms of the agreements, are expensed as incurred.

Research and Development

The Corporation expenses research and development as incurred. Research and development expense was $26.3 million, $26.2 million and $24.2 million in 1994, 1993 and 1992, respectively.

Advertising

The Corporation expenses advertising costs as incurred. Advertising expense was $120.6 million, $130.0 million and $137.6 million in 1994, 1993 and 1992, respectively. Prepaid advertising as of December 31, 1994 and 1993 was $8.5 million and $1.6 million, respectively.

2. Acquisitions and Divestiture

In October 1993, the Corporation completed the purchase of the outstanding shares of Overspecht B.V. (OZF Jamin) for approximately $20.2 million, plus the assumption of approximately $13.4 million in debt. OZF Jamin manufactures chocolate and non-chocolate confectionery products, cookies, biscuits and ice cream for distribution primarily to customers in the Netherlands and Belgium.

In September 1993, the Corporation completed the acquisition of the Italian confectionery business of Heinz Italia S.p.A. (Sperlari) for approximately $130.0 million. Sperlari is a leader in the Italian non-chocolate confectionery market and manufactures and distributes a wide range of confectionery products, including nougat and sugar candies. Products are marketed primarily under the *Sperlari, Dondi* and *Scaramellini* brands.

In March 1993, the Corporation acquired certain assets of the Cleveland-area Ideal Macaroni and Weiss Noodle companies for approximately $14.6 million.

In accordance with the purchase method of accounting, the purchase prices of the acquisitions summarized above were allocated to the underlying assets and liabilities at the date of acquisition based on their estimated respective fair values which may be revised at a later date. Total liabilities assumed, including debt, were $54.0 million in 1993. Results subsequent to the dates of acquisition are included in the consolidated financial statements. Had the results of these acquisitions been included in consolidated results for the entire length of each period presented, the effect would not have been material.

In April 1992, the Corporation completed the sale of Hershey do Brasil Participacoes Ltda., a holding company which owned a 41.7% equity interest in Petybon S.A., to the Bunge & Born Group for approximately $7.0 million. Petybon S.A., located in Brazil, is a producer of pasta, biscuits and margarine products. The sale resulted in a modest pre-tax gain and a reduction in the effective income tax rate of .8% for 1992.

3. Restructuring Charge

In the fourth quarter of 1994, the Corporation recorded a pre-tax restructuring charge of $106.1 million following a comprehensive review of domestic and international operations designed to enhance performance of operating assets by lowering operating and administrative costs, eliminating underperforming assets and streamlining the overall decision-making process. The charge of $106.1 million resulted in an after-tax charge of $80.2 million or $.92 per share in 1994.

The charge included $34.3 million of severance and termination benefits for the elimination of approximately 500 positions in the manufacturing, technical and administrative areas at both domestic and international operations. The charge also included anticipated losses on disposals of certain businesses of $39.1 million, product line discontinuations of $17.5 million and the consolidation of operations and disposal of machinery and equipment of $15.2 million. Approximately 60% of the charge was non-cash. Operating cash flows will be used to fund any severance or other cash items.

As of December 31, 1994, $24.0 million of the accrued restructuring reserves had been utilized, including $15.0 million related to product line discontinuations, $3.5 million for consolidation of operations and disposal of machinery and equipment, $3.8 million for severance liabilities and $1.7 million related to the effect of currency translation.

4. Gain on Sale of Investment Interest

In May 1992, the Corporation completed the acquisition of an 18.6% investment interest in Freia Marabou a.s (Freia) for $179.1 million. The investment was accounted for under the cost method in 1992. In October 1992, the Corporation tendered its investment interest in response to a Kraft General Foods Holdings Norway, Inc. (KGF) bid to acquire Freia subject to certain conditions, including approval by the Norwegian government.

KGF received approval of its ownership and, in March 1993, the Corporation recorded a pre-tax gain of $80.6 million on the sale of its Freia investment. This gain had the effect of increasing net income by $40.6 million. Gross proceeds from the sale in the amount of $259.7 million were received in April 1993.

5. Rental and Lease Commitments

Rent expense was $25.7 million, $24.5 million and $24.0 million for 1994, 1993 and 1992, respectively. Rent expense pertains to all operating leases which were principally related to certain administrative buildings, distribution facilities and transportation equipment. Future minimum rental payments under non-cancellable operating leases with a remaining term in excess of one year as of December 31, 1994, were: 1995, $12.9 million; 1996, $12.0 million; 1997, $11.3 million; 1998, $10.8 million; 1999, $12.6 million; 2000 and beyond, $93.4 million.

6. Financial Instruments

The carrying amounts of financial instruments including cash and cash equivalents, accounts receivable, accounts payable and short-term debt approximated fair value as of December 31, 1994 and 1993, because of the relatively short maturity of these instruments. The carrying value of long-term debt, including the current portion, approximated fair value as of December 31, 1994 and 1993, based upon quoted market prices for the same or similar debt issues.

As of December 31, 1994, the Corporation had foreign exchange forward contracts maturing in 1995 and 1996 to purchase $35.7 million in foreign currency, primarily British sterling and Canadian dollars, and to sell $7.5 million in foreign currency, primarily Japanese yen, at contracted forward rates.

To hedge foreign currency exposure related to anticipated transactions associated with the purchase of certain raw materials and finished goods generally covering 3 to 24 months, the Corporation also purchases foreign exchange options which permit but do not require the Corporation to exchange foreign currencies at a future date with another party at a contracted exchange rate. To finance premiums paid on such options, from time to time the Corporation may also write offsetting options at exercise prices which limit but do not eliminate the effect of purchased options and forward contracts as a hedge. As of December 31, 1994, the Corporation had purchased foreign exchange options of $11.6 million and written foreign exchange options of $10.9 million, principally related to British sterling.

The fair value of foreign exchange forward contracts is estimated by obtaining quotes for future contracts with similar terms, adjusted where necessary for maturity differences, and the fair value of foreign exchange options is estimated using active exchange quotations. As of December 31, 1994, the fair value of foreign exchange forward and options contracts approximated carrying value. The Corporation does not hold or issue financial instruments for trading purposes.

As of December 31, 1993, the Corporation had foreign exchange forward contracts maturing in 1994 and 1995 to purchase $39.1 million in foreign currency, primarily British sterling and Canadian dollars, and to sell $3.6 million in foreign currency at contracted forward rates.

7. Interest Expense

Interest expense, net consisted of the following:

For the years ended December 31,	**1994**	1993	1992
In thousands of dollars			
Long-term debt and lease obligations	**$19,103**	$23,016	$ 30,435
Short-term debt	**21,155**	11,854	11,328
Capitalized interest	**(3,009)**	(4,646)	(12,055)
Interest expense, gross	**37,249**	30,224	29,708
Interest income	**(1,892)**	(3,229)	(2,468)
Interest expense, net	**$35,357**	$26,995	$ 27,240

8. Short-term Debt

Generally, the Corporation's short-term borrowings are in the form of commercial paper or bank loans with an original maturity of three months or less. The Corporation maintained lines of credit arrangements with domestic and international commercial banks, under which it could borrow in various currencies up to $516 million as of December 31, 1994, and up to $560 million as of December 31, 1993, at the lending banks' prime commercial interest rates or lower. These lines of credit, which may be used to support commercial paper borrowings, may be terminated at the option of the Corporation. The Corporation had combined domestic commercial paper borrowings and short-term international bank loans against these lines of credit of $316.8 million and $337.3 million as of December 31, 1994 and 1993, respectively. The weighted average interest rates on short-term borrowings outstanding as of December 31, 1994 and 1993, were 6.0% and 3.8%, respectively.

Lines of credit were supported by commitment fee arrangements. The fees were generally ⅛% per annum of the commitment. There were no significant compensating balance agreements which legally restricted these funds.

As a result of maintaining a consolidated cash management system, the Corporation maintains overdraft positions at certain banks. Such overdrafts, which were included in accounts payable, were $23.0 million and $17.2 million as of December 31, 1994 and 1993, respectively.

9. Long-term Debt

Long-term debt consisted of the following:

December 31, In thousands of dollars	1994	1993
Medium-term Notes, 8.45% to 9.92%, due 1994–1998	$ 45,400	$ 55,400
8.8% Debentures due 2021	100,000	100,000
Other obligations, net of unamortized debt discount	19,781	23,666
Total long-term debt	165,181	179,066
Less — current portion	7,954	13,309
Long-term portion	$157,227	$165,757

Aggregate annual maturities during the next five years are: 1995, $8.0 million; 1996, $2.4 million; 1997, $16.0 million; 1998, $25.6 million; and 1999, $.6 million. The Corporation's debt is principally unsecured and of equal priority. None of the debt is convertible into stock of the Corporation. The Corporation is in compliance with all covenants included in the related debt agreements.

10. Income Taxes

Effective January 1, 1993, the Corporation adopted Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" (FAS No. 109), which requires the use of the liability method of accounting for deferred income taxes. This change in accounting as of January 1, 1993, which was recorded as a catch-up adjustment, increased 1993 net income by $8.2 million or $.09 per share.

Income before income taxes and accounting changes was as follows:

For the years ended December 31, In thousands of dollars	1994	1993	1992
Domestic	$411,089	$417,226	$388,685
International	(77,951)	13,007	12,303
Gain on sale of investment interest	—	80,642	—
Income before income taxes and accounting changes	$333,138	$510,875	$400,988

The provision for income taxes, excluding the FAS No. 109 catch-up adjustment in 1993, was as follows:

For the years ended December 31, In thousands of dollars	1994	1993	1992
Current:			
Federal	$126,234	$141,541	$104,223
State	24,712	37,358	30,968
International	301	23,696	1,795
Current provision for income taxes	151,247	202,595	136,986
Deferred:			
Federal	6,221	2,949	11,770
State	2,652	1,764	4,579
International	(11,201)	6,334	5,055
Deferred provision for income taxes	(2,328)	11,047	21,404
Total provision for income taxes	$148,919	$213,642	$158,390

The 1994 International deferred income tax benefit was associated primarily with the restructuring charge recorded in the fourth quarter.

The tax effects of the significant temporary differences which comprised the deferred tax assets and liabilities were as follows:

	December 31, 1994		December 31, 1993	
	Deferred Income Tax Assets	Deferred Income Tax Liabilities	Deferred Income Tax Assets	Deferred Income Tax Liabilities
In thousands of dollars				
Current:				
Post-retirement benefit obligations	$ 3,496	$ —	$ 3,478	$ —
Accrued restructuring reserves	19,598	—	—	—
Accrued expenses and other reserves	68,030	—	70,678	—
Other	22,948	8,124	16,555	5,163
Total current deferred income taxes	114,072	8,124	90,711	5,163
Non-current:				
Depreciation	—	231,035	—	214,566
Post-retirement benefit obligations	82,034	—	78,190	—
Accrued expenses and other reserves	22,845	—	24,800	—
Other	15,795	83,016	10,744	71,912
Total non-current deferred income taxes	120,674	314,051	113,734	286,478
Total deferred income taxes	$234,746	$322,175	$204,445	$291,641

The following table reconciles the Federal statutory income tax rate with the Corporation's effective income tax rate:

For the years ended December 31,	1994	1993	1992
Federal statutory tax rate	35.0%	35.0%	34.0%
Increase (reduction) resulting from:			
State income taxes, net of Federal income tax benefits	6.0	6.2	6.0
Restructuring charge for which no tax benefit was provided	4.5	—	—
Non-deductible acquisition costs	0.8	0.6	0.9
Other, net	(1.6)	—	(1.4)
Effective income tax rate	44.7%	41.8%	39.5%

11. Retirement Plans

The Corporation and its subsidiaries sponsor several defined benefit retirement plans covering substantially all employees. Plans covering most domestic salaried and hourly employees provide retirement benefits based on individual account balances which are increased annually by pay-related and interest credits. Plans covering certain non-domestic employees provide retirement benefits based on career average pay, final pay, or final average pay as defined within the provisions of the individual plans. The Corporation also participates in several multi-employer retirement plans which provide defined benefits to employees covered under certain collective bargaining agreements.

The Corporation's policy is to fund domestic pension liabilities in accordance with the minimum and maximum limits imposed by the Employee Retirement Income Security Act of 1974 and Federal income tax laws, respectively. Non-domestic pension liabilities are funded in accordance with applicable local laws and regulations. Plan assets are invested in a broadly diversified portfolio consisting primarily of domestic and international common stocks and fixed income securities.

Pension expense included the following components:

For the years ended December 31, In thousands of dollars	**1994**	1993	1992
Service cost	**$ 30,077**	$ 27,835	$ 22,858
Interest cost on projected benefit obligations	**28,351**	26,423	24,098
Investment loss (return) on plan assets	**8,288**	(46,232)	(12,331)
Net amortization and deferral	**(40,550)**	18,519	(15,245)
Corporate sponsored plans	**26,166**	26,545	19,380
Multi-employer plans	**374**	612	580
Other	**622**	678	630
Total pension expense	**$ 27,162**	$ 27,835	$ 20,590

The funded status and amounts recognized in the consolidated balance sheets for the retirement plans were as follows:

	December 31, 1994		December 31, 1993	
In thousands of dollars	Assets Exceeded Accumulated Benefits	Accumulated Benefits Exceeded Assets	Assets Exceeded Accumulated Benefits	Accumulated Benefits Exceeded Assets
Actuarial present value of:				
Vested benefit obligations	**$310,061**	**$33,272**	$144,608	$204,861
Accumulated benefit obligations	**$330,161**	**$39,966**	$155,838	$221,867
Actuarial present value of projected benefit obligations	**$367,656**	**$43,250**	$185,926	$231,972
Plan assets at fair value	**341,373**	**1,748**	166,727	181,813
Plan assets less than projected benefit obligations	**26,283**	**41,502**	19,199	50,159
Net gain (loss) unrecognized at date of transition	**1,711**	**(2,198)**	(5,440)	4,381
Prior service cost and amendments not yet recognized in earnings	**(19,620)**	**(1,744)**	94	(11,556)
Unrecognized net loss from past experience different than that assumed	**(9,711)**	**(455)**	(7,171)	(13,948)
Minimum liability adjustment	**—**	**4,031**	—	14,866
(Prepaid pension expense) pension liability	**$ (1,337)**	**$41,136**	$ 6,682	$ 43,902

The projected benefit obligations for the plans were determined principally using discount rates of 8.5% and 7.0% as of December 31, 1994 and 1993, respectively. For both 1994 and 1993 the assumed long-term rate of return on plan assets was 9.5%. The assumed long-term compensation increase rates for 1994 and 1993 were primarily 4.8% and 6.0%, respectively.

12. Post-retirement Benefits

The Corporation and its subsidiaries provide certain health care and life insurance benefits for retired employees subject to pre-defined limits. Substantially all of the Corporation's domestic employees become eligible for these benefits at retirement with a pre-defined benefit being available at an early retirement date. The post-retirement medical benefit is contributory for pre-Medicare retirees and for most post-Medicare retirees retiring on or after February 1, 1993. Retiree contributions are based upon a combination of years of service and age at retirement. The post-retirement life insurance benefit is non-contributory.

Effective January 1, 1993, the Corporation adopted Statement of Financial Accounting Standards No. 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions" (FAS No. 106) which requires that the cost of post-retirement benefits be accrued during employees' working careers. The Corporation elected to adopt FAS No. 106 by means of a catch-up adjustment. This change in accounting as of January 1, 1993, had the effect of decreasing net income by $112.2 million, or $1.25 per share, after a deferred tax benefit of $76.3 million.

Prior to 1993, the Corporation accounted for such benefits as an expense as paid. Expense recognized under FAS No. 106 during 1993 incrementally reduced net income by $5.9 million.

Net post-retirement benefit costs consisted of the following components:

For the years ended December 31, In thousands of dollars	**1994**	1993
Service cost	**$ 3,642**	$ 3,997
Interest cost on projected benefit obligations	**13,334**	12,897
Amortization	**(1,028)**	(280)
Total	**$15,948**	$16,614

Obligations are unfunded and the actuarial present values of accumulated post-retirement benefit obligations recognized in the consolidated balance sheets were as follows:

December 31, In thousands of dollars	**1994**	1993
Retirees	**$ 92,051**	$ 87,765
Fully eligible active plan participants	**26,030**	31,852
Other active plan participants	**49,338**	65,069
Total	**167,419**	184,686
Plan amendments	**19,224**	5,746
Unrecognized net gain from past experience different than that assumed	**20,285**	7,976
Accrued post-retirement benefits	**$206,928**	$198,408

The accumulated post-retirement benefit obligations were determined principally using discount rates of 8.5% and 7.5% as of December 31, 1994 and 1993, respectively. The assumed average health care cost trend rate used in measuring the accumulated post-retirement benefit obligations as of December 31, 1994 and 1993, was principally 12%, gradually declining to approximately 7% by 2003, and remaining at that level thereafter. A one percentage point increase in the average health care cost trend rate for each year would increase the accumulated post-retirement benefit obligations as of December 31, 1994 and 1993, by $23.5 million and $18.3 million, respectively, and would increase the sum of the net service and interest cost components of net post-retirement benefit costs for 1994 and 1993 by $2.8 million and $2.2 million, respectively.

As part of its long-range financing plans, the Corporation, in 1989, implemented a corporate-owned life insurance program covering most of its domestic employees. After paying employee death benefits, proceeds from this program will be available for general corporate purposes and may be used to offset future employee benefits costs, including retiree medical benefits. The Corporation's investment in corporate-owned life insurance policies was recorded net of policy loans in other assets, and interest accrued on the policy loans was included in accrued liabilities as of December 31, 1994 and 1993. Net life insurance expense, including interest expense, was included in selling, marketing and administrative expenses.

13. Employee Stock Ownership Trust

The Corporation's employee stock ownership trust (ESOP) serves as the primary vehicle for contributions to its existing employee savings and stock investment plan for participating domestic salaried and hourly employees. The ESOP was funded by a 15-year 7.75% loan of $47.9 million from the Corporation. During 1994 and 1993, the ESOP received a combination of dividends on unallocated shares and contributions from the Corporation equal to the amount required to meet its principal and interest payments under the loan. Simultaneously, the ESOP allocated to participants 79,588 shares of Common Stock each year. As of December 31, 1994, the ESOP held 221,334 of allocated shares and 955,052 of unallocated shares. All ESOP shares are considered outstanding for income per share computations.

The Corporation recognized net compensation expense equal to the shares allocated multiplied by the original cost of $40⅛ per share less dividends received by the ESOP on unallocated shares. Compensation expense related to the ESOP for 1994, 1993 and 1992 was $1.7 million, $2.0 million and $2.3 million, respectively. Dividends paid on unallocated ESOP shares were $1.2 million in 1994 and 1993, and $.9 million in 1992. The unearned ESOP compensation balance in stockholders' equity represented deferred compensation expense to be recognized by the Corporation in future years as additional shares are allocated to participants.

14. Capital Stock and Net Income Per Share

As of December 31, 1994, the Corporation had 530,000,000 authorized shares of capital stock. Of this total, 450,000,000 shares were designated as Common Stock, 75,000,000 shares as Class B Common Stock (Class B Stock), and 5,000,000 shares as Preferred Stock, each class having a par value of one dollar per share. As of December 31, 1994, a combined total of 89,922,336 shares of both classes of common stock had been issued of which 86,735,197 shares were outstanding. No shares of the Preferred Stock were issued or outstanding during the three-year period ended December 31, 1994.

Holders of the Common Stock and the Class B Stock generally vote together without regard to class on matters submitted to stockholders, including the election of directors, with the Common Stock having one vote per share and the Class B Stock having ten votes per share. However, the Common Stock, voting separately as a class, is entitled to elect one-sixth of the Board of Directors. With respect to dividend rights, the Common Stock is entitled to cash dividends 10% higher than those declared and paid on the Class B Stock.

Class B Stock can be converted into Common Stock on a share-for-share basis at any time. During 1994, 1993 and 1992, a total of 10,300 shares, 4,000 shares and 7,775 shares, respectively, of Class B Stock were converted into Common Stock.

Hershey Trust Company, as Trustee for Milton Hershey School (Hershey Trust), as institutional fiduciary for estates and trusts unrelated to Milton Hershey School, and as direct owner of investment shares, held a total of 21,379,501 shares of the Common Stock, and as Trustee for Milton Hershey School, held 15,153,003 shares of the Class B Stock as of December 31, 1994, and was entitled to cast approximately 77% of the total votes of both classes of the Corporation's common stock. Hershey Trust must approve the issuance of shares of Common Stock or any other action which would result in the Hershey Trust not continuing to have voting control of the Corporation.

In 1993, the Corporation's Board of Directors approved a share repurchase program to acquire from time to time through open market or privately negotiated transactions up to $200 million of Common Stock. A total of 3,451,139 shares of Common Stock had been acquired for approximately $171.5 million under the share repurchase program as of December 31, 1994, of which 264,000 shares were retired and the remaining 3,187,139 shares were held as treasury stock. During 1994, 878,039 shares were repurchased at an average price of $45 per share. Of the total purchased, 2,000,000 shares were acquired from Hershey Trust in 1993 for approximately $103.1 million.

Net income per share has been computed based on the weighted average number of shares of the Common Stock and the Class B Stock outstanding during the year. Average shares outstanding were 87,018,626 for 1994, 89,757,135 for 1993 and 90,186,336 for 1992.

15. Incentive Plan

The long-term portion of the 1987 Key Employee Incentive Plan, as amended (Plan), provides for grants or awards to senior executives and key employees of one or more of the following: performance stock units, non-qualified stock options (stock options), stock appreciation rights and restricted stock units. The Plan also provides for the deferral of performance stock unit awards by participants.

As of December 31, 1994, a total of 136,615 contingent performance stock units had been granted for potential future distribution, primarily related to three-year cycles ending December 31, 1994, 1995 and 1996. Deferred performance stock units and accumulated dividend amounts totaled 196,081 shares as of December 31, 1994.

Stock options are granted at exercise prices of not less than 100% of the fair market value of a share of Common Stock at the time the option is granted and are exercisable for periods no longer than ten years from the date of grant. Each option may be used to purchase one share of Common Stock. No compensation expense is recognized under the stock options portion of the Plan.

No stock appreciation rights or restricted stock units were outstanding as of December 31, 1994.

Stock option activity was as follows:

	Shares under Options	
	Number of Shares	Option Price per Share
Outstanding — January 1, 1992	857,125	$23¾ to 36¼
Granted	939,000	$41⅛ to 44¾
Exercised	(69,650)	$23¾ to 35⅜
Cancelled	(9,500)	$44¾
Outstanding — December 31, 1992	1,716,975	$25⅜ to 44¾
Granted	116,600	$47 to 53
Exercised	(82,850)	$25⅜ to 35⅜
Cancelled	(20,300)	$44¾
Outstanding — December 31, 1993	1,730,425	$25⅜ to 53
Granted	**963,800**	**$49**
Exercised	**(104,975)**	**$25⅜ to 44¾**
Cancelled	**(55,300)**	**$44¾ to 49**
Outstanding — December 31, 1994	**2,533,950**	**$25⅜ to 53**

Stock options exercisable as of December 31, 1994 and 1993 were 1,734,750 and 951,725, respectively.

16. Supplemental Balance Sheet Information

Accounts Receivable — Trade

In the normal course of business, the Corporation extends credit to customers which satisfy pre-defined credit criteria. The Corporation believes that it has little concentration of credit risk due to the diversity of its customer base. Receivables, as shown on the consolidated balance sheets, were net of allowances and anticipated discounts of $14.0 million and $12.5 million as of December 31, 1994 and 1993, respectively.

Inventories

The Corporation values the majority of its inventories under the last-in, first-out (LIFO) method and the remaining inventories at the lower of first-in, first-out (FIFO) cost or market. LIFO cost of inventories valued using the LIFO method was $318.5 million and $310.6 million as of December 31, 1994 and 1993, respectively, and all inventories were stated at amounts that did not exceed realizable values. Total inventories were as follows:

December 31, In thousands of dollars	1994	1993
Raw materials	**$234,317**	$209,570
Goods in process	**28,680**	37,261
Finished goods	**247,272**	265,616
Inventories at FIFO	**510,269**	512,447
Adjustment to LIFO	**(64,567)**	(59,005)
Total inventories	**$445,702**	$453,442

Property, Plant and Equipment

Property, plant and equipment balances included construction in progress of $76.9 million and $171.1 million as of December 31, 1994 and 1993, respectively. Major classes of property, plant and equipment were as follows:

December 31, In thousands of dollars	1994	1993
Land	**$ 50,678**	$ 48,239
Buildings	**467,950**	430,199
Machinery and equipment	**1,604,901**	1,563,326
Property, plant and equipment, gross	**2,123,529**	2,041,764
Accumulated depreciation	**(655,132)**	(580,860)
Property, plant and equipment, net	**$1,468,397**	$1,460,904

Accrued Liabilities

Accrued liabilities were as follows:

December 31, In thousands of dollars	1994	1993
Payroll and other compensation	**$ 67,155**	$ 81,909
Advertising and promotion	**81,561**	89,819
Other	**116,567**	130,261
Total accrued liabilities	**$265,283**	$301,989

Other Long-term Liabilities

Other long-term liabilities were as follows:

December 31, In thousands of dollars	1994	1993
Accrued post-retirement benefits	**$198,251**	$189,959
Other	**104,805**	100,442
Total other long-term liabilities	**$303,056**	$290,401

17. Segment Information

The Corporation operates in a single consumer foods line of business, encompassing the domestic and international manufacture, distribution and sale of chocolate, confectionery, grocery and pasta products.

Operations in Canada and Europe represent the majority of the Corporation's international business. Historically, transfers of product between geographic areas have not been significant. In 1994, sales to Wal-Mart Stores, Inc. and Subsidiaries amounted to approximately 10% of total net sales. Net sales, income before interest, income taxes and accounting changes, and identifiable assets by geographic segment were as follows:

For the years ended December 31, In thousands of dollars	**1994**	1993	1992
Net sales:			
Domestic	**$3,124,155**	$3,080,329	$2,871,438
International	**482,116**	407,920	348,367
Total	**$3,606,271**	$3,488,249	$3,219,805
Income (loss) before interest, income taxes and accounting changes:			
Domestic	**$ 446,585**	$ 446,565	$ 419,317
International	**(78,090)**	10,663	8,911
Gain on sale of investment interest	**—**	80,642	—
Total	**$ 368,495**	$ 537,870	$ 428,228
Identifiable assets as of December 31:			
Domestic	**$2,338,184**	$2,281,766	$2,353,230
International	**552,797**	573,325	319,679
Total	**$2,890,981**	$2,855,091	$2,672,909

18. Quarterly Data (Unaudited)

Summary quarterly results were as follows:

In thousands except per share amounts

Year 1994	**First**	**Second**	**Third**	**Fourth**
Net sales	**$883,890**	**$675,983**	**$966,511**	**$1,079,887**
Gross profit	**357,162**	**272,883**	**404,543**	**474,127**
Net income	**53,016**	**25,325**	**81,063**	**24,815**[a]
Net income per share	**.61**	**.29**	**.93**	**.29**
Weighted average shares outstanding	**87,414**	**87,096**	**86,808**	**86,745**

Year 1993	First	Second	Third	Fourth
Net sales	$ 897,788	$ 618,430	$ 935,662	$ 1,036,369
Gross profit	387,019	254,834	390,846	460,048
Income before cumulative effect of accounting changes	105,055	26,025	73,971	92,182
Net cumulative effect of accounting changes	(103,908)	—	—	—
Net income	1,147[b]	26,025	73,971	92,182
Income per share:[c]				
Before accounting changes	1.16	.29	.82	1.04
Net cumulative effect of accounting changes	(1.15)	—	—	—
Net income	.01	.29	.82	1.04
Weighted average shares outstanding	90,186	90,186	90,124	88,489

(a) Net income for the fourth quarter and year 1994 included an after-tax restructuring charge of $80.2 million. Net income per share was similarly impacted.

(b) Net income for the first quarter and year 1993 included the net cumulative effect of accounting changes for post-retirement benefits and income taxes of $(103.9) million and an after-tax gain on the sale of the investment interest in Freia of $40.6 million. Net income per share was similarly impacted.

(c) Quarterly income per share amounts for 1993 do not total to annual amounts due to the changes in weighted average shares outstanding during the year.

Responsibility for Financial Statements

Hershey Foods Corporation is responsible for the financial statements and other financial information contained in this report. The Corporation believes that the financial statements have been prepared in conformity with generally accepted accounting principles appropriate under the circumstances to reflect in all material respects the substance of applicable events and transactions. In preparing the financial statements, it is necessary that management make informed estimates and judgments. The other financial information in this annual report is consistent with the financial statements.

The Corporation maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of the system must be related to the benefits to be derived. The Corporation believes its system provides an appropriate balance in this regard. The Corporation maintains an Internal Audit Department which reviews the adequacy and tests the application of internal accounting controls.

The financial statements have been audited by Arthur Andersen LLP, independent public accountants, whose appointment was ratified by stockholder vote at the stockholders' meeting held on April 25, 1994. Their report expresses an opinion that the Corporation's financial statements are fairly stated in conformity with generally accepted accounting principles, and they have indicated to us that their examination was performed in accordance with generally accepted auditing standards which are designed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The Audit Committee of the Board of Directors of the Corporation, consisting solely of non-management directors, meets regularly with the independent public accountants, internal auditors and management to discuss, among other things, the audit scopes and results. Arthur Andersen LLP and the internal auditors both have full and free access to the Audit Committee, with and without the presence of management.

Report of Independent Public Accountants

To the Stockholders and Board of Directors
of Hershey Foods Corporation:

We have audited the accompanying consolidated balance sheets of Hershey Foods Corporation (a Delaware Corporation) and subsidiaries as of December 31, 1994 and 1993, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1994, appearing on pages 18, 20, 22 and 24 through 36. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hershey Foods Corporation and subsidiaries as of December 31, 1994 and 1993, and the results of their operations and cash flows for each of the three years in the period ended December 31, 1994 in conformity with generally accepted accounting principles.

As discussed in Notes 10 and 12 to the consolidated financial statements, effective January 1, 1993, the Corporation changed its methods of accounting for income taxes and post-retirement benefits other than pensions.

Arthur Andersen LLP

New York, N.Y.
January 27, 1995

Investor Information

Stockholders

As of December 31, 1994, Hershey Foods Corporation had outstanding 71,492,218 shares of Common Stock and 15,242,979 shares of Class B Common Stock.

Year	Year-end Common Stock and Class B Common Stock Holders	Approximate Annual Composite Trading Volume
1994	**34,327**	**31,330**
1993	32,859	29,338
1992	31,642	24,146
1991	31,029	27,975
1990	30,052	31,024

Stock Market Data

Hershey Foods Corporation's Common Stock is listed and traded principally on the New York Stock Exchange under the ticker symbol "HSY." Class B Common Stock is not listed for trading. The stock tables of most financial publications list the Corporation as "Hershey." Options on the Corporation's Common Stock are traded on the American Stock Exchange.

Common Stock Profile

	Common Stock Price			Dividends Paid	
1994	High	Low	Close	Common	Class B
Calendar quarter					
1st Quarter	**$53½**	**$45¾**	**$46⅜**	**$.300**	**$.2725**
2nd Quarter	**46¾**	**41⅝**	**43⅜**	**.300**	**.2725**
3rd Quarter	**48**	**41⅛**	**45**	**.325**	**.2950**
4th Quarter	**49⅝**	**44½**	**48⅜**	**.325**	**.2950**

Dividend Policy

Dividends on Hershey Foods Corporation's Common Stock and Class B Common Stock are declared by the Board of Directors, and are normally paid in the months of March, June, September and December.

The dividend to be paid on the Common Stock in March 1995 will be the 261st consecutive regular dividend paid by the Corporation. The dividend rate has been increased annually for 20 consecutive years. Historically, the Corporation has targeted approximately one-third of income from continuing operations as dividends to stockholders.

Dividend Reinvestment Service

The Corporation offers an Automatic Dividend Reinvestment Service to registered holders of Hershey Foods Common Stock. This service provides a convenient method of increasing share ownership without paying brokerage commissions or service fees. The Corporation pays all commissions and fees associated with stock purchases made with reinvested dividends. However, under Internal Revenue Service regulations, any fees paid on behalf of stockholders are considered taxable income and will be included on their Form 1099-DIV Statement of Dividends and Distributions. Participants also may make voluntary cash payments of up to $20,000 annually, for which there are only nominal brokerage commissions and service fees. Approximately one-third of Hershey Foods Corporation's registered stockholders are enrolled in this Automatic Dividend Reinvestment Service. For more information, contact:

Chemical Bank
Dividend Reinvestment Department
J.A.F. Building
P.O. Box 3069
New York, NY 10116-3069
(800) 851-4216

Safekeeping of Stock Certificates

Your stock certificate is a valuable document and should be kept in a safe place such as a safe deposit box. Stock certificates should not be signed until sold or transferred to another person. For tax purposes, please keep a record of each certificate, including the original cost. This record should be kept in a separate place from the certificates.

Stockholder Inquiries

Questions relating to stockholder records, change of ownership, change of address and dividend payments should be sent to the Corporation's Transfer Agent, Chemical Bank, listed on page 40.

Financial Information

Security analysts, investment managers and stockholders should direct financial information inquiries to the Investor Relations contact listed on page 40.

Directors and Senior Management*

Board of Directors

Kenneth L. Wolfe
Chairman of the Board and
Chief Executive Officer

Howard O. Beaver, Jr.
Retired Chairman of the Board
Carpenter Technology Corporation
Reading, Pa.

Thomas C. Graham
Chairman of the Board and
Chief Executive Officer
AK Steel Corporation
Middletown, Ohio

Bonnie Guiton Hill
Dean, McIntire School of Commerce
University of Virginia
Charlottesville, Va.

John C. Jamison
Chairman
Mallardee Associates
Williamsburg, Va.

Sybil C. Mobley, Ph.D.
Dean, School of Business
and Industry
Florida Agricultural and
Mechanical University
Tallahassee, Fla.

Francine I. Neff
Vice President and Director
NETS Inc.
Albuquerque, N.M.

Rod J. Pera
Attorney
Santa Fe, N.M.

John M. Pietruski
Chairman of the Board
Texas Biotechnology Corp.
Houston, Texas

Vincent A. Sarni
Retired Chairman of the Board
and Chief Executive Officer
PPG Industries, Inc.
Pittsburgh, Pa.

Joseph P. Viviano
President and
Chief Operating Officer

Audit Committee
Howard O. Beaver, Jr., Chair
Bonnie Guiton Hill
John C. Jamison
Francine I. Neff
Rod J. Pera

Committee on Directors and Corporate Governance
John C. Jamison, Chair
Howard O. Beaver, Jr.
Sybil C. Mobley, Ph.D.
Vincent A. Sarni
Kenneth L. Wolfe

Compensation and Executive Organization Committee
John M. Pietruski, Chair
Thomas C. Graham
Francine I. Neff
Vincent A. Sarni

Employee Benefit Committee
Thomas C. Graham, Chair
Bonnie Guiton Hill
Sybil C. Mobley, Ph.D.
Rod J. Pera
John M. Pietruski

Executive Committee
Kenneth L. Wolfe, Chair
Joseph P. Viviano

Corporate Officers

Kenneth L. Wolfe
Chairman of the Board
and Chief Executive Officer

Joseph P. Viviano
President and
Chief Operating Officer

William F. Christ
Senior Vice President
and Chief Financial Officer

Charles L. Duncan, Ph.D.
Vice President
Research and Development

Thomas C. Fitzgerald
Vice President and Treasurer

R. Montgomery Garrabrant
Controller and
Chief Accounting Officer

Eleanor S. Gathany
Acting Secretary

Sharon A. Lambly
Vice President
Human Resources

William Lehr, Jr.
Vice President

Robert M. Reese
Vice President and
General Counsel

Barry L. Zoumas, Ph.D.
Vice President
Science and Technology

Division Executives

Jay F. Carr
President
Hershey International

Dennis N. Eshleman
General Manager
Hershey Grocery

Michael F. Pasquale
President
Hershey Chocolate
North America

C. Mickey Skinner
President
Hershey Pasta Group

*As of February 28, 1995

Stockholder Information

Executive Offices
100 Crystal A Drive
P. O. Box 810
Hershey, PA 17033-0810
(717) 534-6799

Transfer Agent and Registrar
Chemical Bank
J.A.F. Building
P. O. Box 3068
New York, NY 10116-3068
(800) 851-4216

Independent Public Accountants
Arthur Andersen LLP
1345 Avenue of the Americas
New York, NY 10105

Investor Relations Contact
James A. Edris, Director
Investor Relations
100 Crystal A Drive
P. O. Box 810
Hershey, PA 17033-0810
(717) 534-7552

Form 10-K
Form 10-K, filed annually in March with the Securities and Exchange Commission, is available without charge by contacting:

Office of the Corporate Secretary
Hershey Foods Corporation
100 Crystal A Drive
P. O. Box 810
Hershey, PA 17033-0810
(717) 534-7527

Annual Meeting
The Annual Meeting of Stockholders will be held at 2:00 p.m. on Monday, April 24, 1995, at the Hershey Theatre, located one-half block east of Cocoa Avenue on East Caracas Avenue, Hershey, Pa.
A formal notice of this meeting, together with a proxy statement, will be mailed to stockholders on or about March 13, 1995.

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1990	1989	1988	1987	1986	1985	1984
2,715,609	2,420,988	2,168,048	1,863,816	1,635,486	1,526,584	1,423,396
1,588,360	1,455,612	1,326,458	1,149,663	1,032,061	982,370	934,817
776,668	655,040	575,515	468,062	387,227	345,299	309,587
35,540	—	—	—	—	—	—
—	—	—	—	—	—	—
24,603	20,414	29,954	22,413	8,061	10,240	8,325
145,636	118,868	91,615	99,604	100,931	91,910	82,986
215,882	171,054	144,506	124,074	107,206	96,765	87,681
—	—	—	—	—	—	—
—	—	69,443	24,097	25,558	15,462	21,001
215,882	171,054	213,949	148,171	132,764	112,227	108,682
2.39[i]	1.90	1.60	1.38	1.15	1.03	.93
—	—	—	—	—	—	—
2.39[i]	1.90	2.37	1.64	1.42	1.19	1.16
90,186	90,186	90,186	90,186	93,508	94,011	94,011
74,161[e]	55,431	49,433	43,436	40,930	37,386	37,073
.990[e]	.740	.660	.580	.520	.475	.413
13,596[e]	10,161	9,097	8,031	7,216	6,556	1,607
.890[e]	.665	.595	.525	.472	.428	.105
7.2%[f]	7.1%	6.7%	6.7%	6.6%	6.3%	6.2%
61,725	54,543	43,721	35,397	31,254	28,348	22,725
146,297	121,182	99,082	97,033	83,600	77,135	71,070
315,242	256,237	230,187	171,162	122,508	105,401	94,921
372,780	340,129	298,483	263,529	238,742	222,267	208,395
179,408	162,032	101,682	68,504	74,452	61,361	45,258
2,078,828	1,814,101	1,764,665	1,544,354	1,262,332	1,116,074	1,052,161
273,442	216,108	233,025	280,900	185,676	86,986	103,155
1,243,537	1,117,050	1,005,866	832,410	727,941	727,899	660,928
13.79	12.39	11.15	9.23	8.07	7.74	7.03
16.6%	16.1%	17.5%	19.0%	18.2%	17.2%	17.3%
13.4%	13.2%	13.3%	13.5%	13.5%	13.5%	13.5%
12,700	11,800	12,100	10,540	10,210	10,380	10,150
90,186	90,186	90,186	90,186	90,186	94,011	94,011
37½	35⅞	26	24½	24⅝	17⅛	12⅞
39⅝–28¼	36⅞–24¾	28⅝–21⅞	37¾–20¾	30–15½	18⅜–11⅝	13¾–9⅜

Notes

(a) All amounts for years prior to 1988 have been restated for discontinued operations, where applicable. Operating Return on Average Stockholders' Equity and Operating Return on Average Invested Capital have been computed using Net Income, excluding the 1988 gain and 1985 loss on disposal included in Discontinued Operations, the 1993 Net Cumulative Effect of Accounting Changes, and the after-tax impacts of the 1990 Restructuring Gain, Net, the 1993 Gain on Sale of the Investment Interest in Freia Marabou a.s (Freia), and the 1994 Restructuring Charge.

(b) All shares and per share amounts have been adjusted for the three-for-one stock split effective September 15, 1986, and the two-for-one stock split effective September 15, 1983.

(c) Calculated percent excludes the 1994 Restructuring Charge. Including the charge, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 5.1%.

(d) Calculated percent excludes the Gain on Sale of Investment Interest in Freia. Including the gain, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 8.5%.

(e) Amounts included a special dividend for 1990 of $11.2 million or $.15 per share of Common Stock and $2.1 million or $.135 per share of Class B Common Stock.

(f) Calculated percent excludes the 1990 Restructuring Gain, Net. Including the gain, Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales was 7.9%.

(g) Income Per Share from Continuing Operations Before Accounting Changes and Net Income Per Share for 1994 included a $.92 per share restructuring charge. Excluding the impact of this charge, Income Per Share from Continuing Operations Before Accounting Changes and Net Income Per Share would have been $3.04.

(h) Income Per Share from Continuing Operations Before Accounting Changes and Net Income Per Share for 1993 included a $.45 per share gain on the sale of the investment interest in Freia. Excluding the impact of this gain, Income Per Share from Continuing Operations Before Accounting Changes would have been $2.86.

(i) Income Per Share from Continuing Operations Before Accounting Changes and Net Income Per Share for 1990 included a $.22 per share Restructuring Gain, Net. Excluding the impact of this gain, Income Per Share from Continuing Operations Before Accounting Changes and Net Income Per Share would have been $2.17.

Hershey Foods Corporation

Eleven-Year Consolidated Financial Summary

All dollar and share amounts in thousands except market price and per share statistics

	10-Year Compound Growth Rate	1994	1993	1992	1991
Summary of Operations[a]					
Net Sales	9.7%	**$3,606,271**	3,488,249	3,219,805	2,899,165
Cost of Sales	8.4%	**$2,097,556**	1,995,502	1,833,388	1,694,404
Selling, Marketing and Administrative	12.8%	**$1,034,115**	1,035,519	958,189	814,459
Restructuring (Charge) Gain, Net		**$ (106,105)**	—	—	—
Gain on Sale of Investment Interest		**$ —**	80,642	—	—
Interest Expense, Net	15.6%	**$ 35,357**	26,995	27,240	26,845
Income Taxes	6.0%	**$ 148,919**	213,642	158,390	143,929
Income from Continuing Operations Before Accounting Changes	7.7%	**$ 184,219**	297,233	242,598	219,528
Net Cumulative Effect of Accounting Changes		**$ —**	(103,908)	—	—
Discontinued Operations		**$ —**	—	—	—
Net Income	5.4%	**$ 184,219**	193,325	242,598	219,528
Income Per Share:					
From Continuing Operations Before Accounting Changes[b]	8.6%	**$ 2.12**[g]	3.31[h]	2.69	2.43
Net Cumulative Effect of Accounting Changes		**$ —**	(1.16)	—	—
Net Income[b]	6.2%	**$ 2.12**[g]	2.15[h]	2.69	2.43
Weighted Average Shares Outstanding[b]		**87,019**	89,757	90,186	90,186
Dividends Paid on Common Stock	9.2%	**$ 89,660**	84,711	77,174	70,426
Per Share[b]	11.7%	**$ 1.250**	1.140	1.030	.940
Dividends Paid on Class B Common Stock	26.8%	**$ 17,301**	15,788	14,270	12,975
Per Share[b]	26.9%	**$ 1.135**	1.035	.935	.850
Income from Continuing Operations Before Accounting Changes as a Percent of Net Sales		**7.3%**[c]	7.4%[d]	7.5%	7.6%
Depreciation	17.6%	**$ 114,821**	100,124	84,434	72,735
Advertising	5.4%	**$ 120,629**	130,009	137,631	117,049
Promotion	16.0%	**$ 419,164**	444,546	398,577	325,465
Payroll	8.5%	**$ 472,997**	469,564	433,162	398,661
Year-end Position and Statistics[a]					
Capital Additions	11.9%	**$ 138,711**	211,621	249,795	226,071
Total Assets	10.6%	**$2,890,981**	2,855,091	2,672,909	2,341,822
Long-term Portion of Debt	4.3%	**$ 157,227**	165,757	174,273	282,933
Stockholders' Equity	8.1%	**$1,441,100**	1,412,344	1,465,279	1,335,251
Net Book Value Per Share[b]	9.0%	**$ 16.61**	16.12	16.25	14.81
Operating Return on Average Stockholders' Equity		**18.5%**	17.8%	17.3%	17.0%
Operating Return on Average Invested Capital		**15.6%**	15.0%	14.4%	13.8%
Full-time Employees		**14,000**	14,300	13,700	14,000
Stockholders' Data					
Outstanding Shares of Common Stock and Class B Common Stock at Year-end[b]		**86,735**	87,613	90,186	90,186
Market Price of Common Stock at Year-end[b]	14.2%	**$ 48⅜**	49	47	44⅜
Range During Year[b]		**$53½–41⅛**	55⅞–43½	48⅜–38¼	44½–35⅛

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